# ERISA Health Care Plan Reimbursement From The Beneficiary's Personal Injury Recovery

Summary: Health care plan reimbursement has been a contentious issue for plaintiffs' personal injury lawyers and health plan lawyers alike. The U.S. Supreme Court's recent *Sereboff* decision adds some clarity, but questions remain.

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Generally, health insurance (or self-funded benefits) provided by an employer or an employee organization to the employees and their dependents is governed by the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §1001 *et seq.* Individual health insurance policies, group health insurance policies that are not employment related, church plans, and government plans are not governed by ERISA.

In the ERISA health insurance or medical benefit context, if the benefit plan pays for a beneficiary's medical expenses arising out of an accident, under what circumstances can the plan obtain reimbursement from a later personal injury recovery by the beneficiary against the tortfeasor?

**The plan must contain a reimbursement provision.**

The ERISA statute itself does not expressly say whether a plan has a right of reimbursement, so we need to turn to the common law or to the terms of the plan.

There is no common law right of implied subrogation in hospital expense, health and accident, or similar insurance (as opposed to liability insurance). With respect

to such insurance, the policy must have an express provision allowing the insurer to subrogate against the tortfeasor or obtain reimbursement from the beneficiary's settlement with the tortfeasor.[1] Moreover, any provision or requirement of an ERISA benefit plan must be in writing.[2]

Accordingly, the ERISA benefit plan must contain an express subrogation or reimbursement provision for the plan to have a right to recoup its medical payments out of the beneficiary's personal injury recovery. Typically, the plan or policy will indeed contain such a provision, but the careful practitioner, representing either the plan or the beneficiary, should double check the plan document to make sure. If the plan document does not contain a reimbursement provision, the beneficiary's attorney should counsel his or her client against signing any separate reimbursement agreement.

**The reimbursement claim is limited to "equitable relief."**

Because ERISA is such a comprehensive and preemptive federal legislative scheme, the plan's reimbursement claim must fit within one of the very specific types of civil actions permitted by the statute. The only type of action under ERISA that the reimbursement claim resembles is that provided by ERISA Section 502(a)(3), 29 U.S.C. §1132(a)(3), concerning a claim for equitable relief to enforce a term of the plan. That section provides:

§1132 Civil Enforcement

(a) Persons empowered to bring a civil action. A civil action may be brought

* * *

(3) by a participant, beneficiary, or *fiduciary* (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain *other appropriate equitable relief* (i) to redress such violations or *(ii) to enforce any* provisions of this subchapter or the *terms of the plan*; (emphasis added).

Jurisdiction for claims under the foregoing provision lies exclusively in federal district court. 29 U.S.C. §1132(e).

Because the benefit plan's claim to enforce the reimbursement provision seeks *money*, *i.e.,* reimbursement for the medical expenses paid by the plan, beneficiaries have challenged whether the claim can be allowed as one for "equitable relief." Arguably, the plan's claim is nothing more than a claim for damages for breach of the reimbursement provision – a claim that plainly seeks legal, not equitable relief. On the other hand, money can be involved in an equitable claim for restitution, to enforce a lien, or under the equity clean-up doctrine. Not surprisingly, the courts have struggled with the benefit plan's reimbursement claim and the circumstances under which it seeks "equitable relief" as opposed to legal damages.

The United States Supreme Court first considered a benefit plan's reimbursement claim in *Great-West Life & Annuity Ins. Co. v. Knudson*.[3] Although Great-West claimed equitable restitution, the Court held that, despite the equitable labels used in the complaint, the facts of the case were such that the action sought only legal damages for breach of the reimbursement clause and, thus, was not permitted under ERISA. Relying on its prior decision in *Mertens v. Hewitt*

*Associates*,[4] a case involving Section 502(a)(3) but not a plan's reimbursement claim, the Court stated that "equitable relief" for purposes of Section 502(a)(3) refers only to "those categories of relief that were typically available in equity."[5] The Court further stated that "not all relief falling under the rubric of restitution is available in equity"[6] and explained that, depending on the circumstances, restitution may be either legal or equitable:

> In cases in which the plaintiff . . . could not assert title or right to possession of particular property, but in which nevertheless he might be able to show just grounds for recovering money to pay for some benefit the defendant had received from him, . . . the plaintiff had a right to restitution at law through an action derived from the common law writ of assumpsit. In such cases, the plaintiff's claim was considered legal because he sought . . . to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money . . .. In contrast, a plaintiff could seek restitution in equity, ordinarily in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant's possession.[7]

In *Knudson* the health plan had paid medical expenses for Mrs. Knudson, a beneficiary under the plan, relating to injuries she suffered in an automobile accident. The plan contained a provision giving it the right to recover from the beneficiary any amounts paid by the plan and recovered from a third party. The

Knudsons settled their tort case arising from the auto accident, and the petitioners (assignees of the health plan) sought to enforce the health plan's reimbursement provision. The settlement funds to which the petitioners claimed entitlement, however, were not in the Knudsons' possession, and the Knudsons were the sole defendants in the reimbursement action. The settlement of the Knudsons' tort action had resulted in the creation of a special needs trust to which most of the settlement proceeds had been directly paid by the tortfeasor. The balance of the settlement funds had been paid to the Knudsons' attorney who took his fee and then disbursed the remainder to the Knudsons' other creditors. The Court found that the petitioners sought *some* funds from the Knudsons, but not a particular fund that in good conscience belonged to the petitioners.[8] Accordingly, the kind of restitution the petitioners sought was legal relief, not equitable relief, and not permitted by ERISA.

Following *Knudson*, lower courts continued to struggle with health care plans' reimbursement claims and with whether such claims sought equitable relief as required by ERISA Section 502(a)(3). Some courts construed *Knudson* as establishing a "possession test," allowing reimbursement if the beneficiary was in possession of clearly identifiable funds from the personal injury settlement.[9] Other courts read *Knudson* more broadly so as to bar plans' reimbursement claims as claims for legal damages because they do not seek the recovery of the actual benefits payments by the plan and, thus, do not seek equitable restitution.[10]

The Supreme Court granted certiorari in *Sereboff v. Mid-Atlantic Medical Services, Inc.*[11] to resolve the disagreement. The Sereboffs were involved in an auto accident and suffered injuries. Their health insurance plan, sponsored by Mrs. Sereboff's employer and covered by ERISA, paid the couple's medical expenses. totaling $74,869.37. The plan had a reimbursement provision requiring a beneficiary who receives benefits to reimburse the plan administrator, Mid Atlantic, from any tort recovery from a third party. The Sereboffs sued several third parties for their injuries arising from the auto accident. On several occasions while the suit was pending, Mid Atlantic sent the Sereboffs' attorney correspondence asserting a lien on the anticipated proceeds from the suit. The Sereboffs' tort action eventually settled, but neither the Sereboffs nor their attorney sent any money to Mid Atlantic. Accordingly, Mid Atlantic filed suit in federal district court to obtain its reimbursement. Because the Sereboffs' attorney had already disbursed the settlement proceeds to them, Mid Atlantic sought a temporary restraining order and preliminary injunction requiring the Sereboffs to retain and set aside at least $74,869.37 from the settlement proceeds. Pursuant to a stipulation, approved by the district court, the Sereboffs agreed to preserve that amount in an investment account pending a final decision on the merits. The district court found in Mid Atlantic's favor and ordered the Sereboffs to pay Mid Atlantic the $74,869.37 with a reduction for Mid Atlantic's share of the Sereboffs' attorney's fees. The Sereboffs appealed, the Fourth Circuit affirmed, and the Supreme Court granted *certiorari*.

In a unanimous opinion, the Court held that Mid Atlantic's recovery could properly be categorized as "equitable relief" and so was authorized by Section 502(a)(3). The Court first noted that the case differed from *Knudson* in that the settlement proceeds were in the Sereboffs' possession whereas in *Knudson* the funds had been placed in a special needs trust under California law.[12] That impediment to characterizing the relief as equitable was not present in *Sereboff*.

The Court employed a new analysis, however, to explain why Mid Atlantic's reimbursement was equitable relief. Relying on a case from the days of the divided law and equity bench, *Barnes v. Alexander*,[13] the Court explained that the reimbursement provision of the ERISA plan caused an "equitable lien by agreement" to arise on the settlement proceeds as soon as those proceeds came into existence and that the lien followed the funds into the hands of the Sereboffs.[14] Such a lien by agreement had been enforced at equity in *Barnes*, which had involved an agreement between attorneys for one-third of the first attorney's future contingent fee expected in a case.

The Sereboffs objected that the reimbursement sought by Mid Atlantic did not meet the conditions for equitable restitution described in *Knudson* in that the funds in their possession could not be traced back to the plan. While acknowledging that equitable restitution generally requires strict tracing, the Court explained that an equitable lien by agreement, the sort at issue here and in *Barnes*, and an equitable lien as a matter of restitution are different species of relief.[15] The Court further explained that it discussed equitable and legal restitution in *Knudson* because

restitution was the remedy claimed by the petitioner there. Demonstrating how the Court often decides cases on very narrow grounds, the Court stated:

> There was no need in *Knudson* to catalog all the circumstances in which equitable liens were available in equity; Great-West claimed a right to recover in restitution, and the Court concluded only that equitable restitution was unavailable because the funds sought were not in Knudson's possession.[16]

*Sereboff* has clarified that, where the ERISA plan is enforcing its reimbursement provision against personal injury settlement proceeds that are still identifiable and in the beneficiary's possession, the recovery is "equitable relief" under Section 502(a)(3) in the way of an equitable lien by agreement. What is important for the plan is to act quickly. As soon as the beneficiary's tort action is settled, or even as it is about to settle, the ERISA plan should go to federal court and seek a TRO and preliminary injunction to freeze enough of the settlement proceeds still in the beneficiary's possession to reimburse the plan for the prior medical expenses and to assert a lien over those proceeds.

But *Sereboff* left many questions unanswered. In many situations, it may be possible for the beneficiary to argue that there no longer exists any identifiable fund upon which an equitable lien may be imposed. What if the tort recovery is commingled with other funds, and what if other persons (not the beneficiary) are additional owners of that account? What if the tort recovery is used to remodel the beneficiary's home to accommodate a disability arising from the accident? What if

the tort recovery is simply spent to pay off debts? What if reimbursement to the ERISA plan would leave the beneficiary with little or nothing from the personal injury settlement?

ERISA Section 502(a)(3), 29 U.S.C. § 1132(a)(3), limits the plan's recovery to "*appropriate* equitable relief." (emphasis added). The Sereboffs argued that reimbursement to the plan was not appropriate in their case because they were not made whole by the tort settlement. The Court declined to consider their argument, however, because it did not appear from the record that this distinct issue had been raised in the courts below.[17] Undoubtedly, the make-whole doctrine[18] and the issue of appropriate equitable relief will receive more attention in the wake of *Sereboff*.

The Court's decisions concerning ERISA Section 502(a)(3), including *Knudson* and *Sereboff*, have been criticized by ERISA scholars as erroneously employing a very narrow view of "equitable relief" based on historical equity practice that was not intended by ERISA's drafters.[19] In the critics' view, the Court's narrow construction of "equitable relief" has not only hampered plan reimbursement efforts, but has undermined ERISA's main purpose of subjecting pension and benefit plans to the concept of trust law so as to protect the interests of participants and beneficiaries. In many cases, the narrow construction of "equitable relief" has left participants and beneficiaries with legitimate grievances without any remedy under ERISA, nor any remedy at all because of ERISA's preemptive effect.[20]

**Reduction by a share of the beneficiary's attorneys' fees**

Other questions unanswered by *Sereboff* are whether the ERISA plan's reimbursement should be reduced by a share of the beneficiary's attorneys' fees in producing the personal injury recovery pursuant to the common fund doctrine and whether the plan document can be drafted to preclude this reduction.[21] Under existing Illinois and Seventh Circuit law, however, if the beneficiary's attorney is patient in taking his or her fee from the settlement, the plan's reimbursement will be reduced by a *pro rata* share of the attorney's fee irrespective of plan language to the contrary.

In *Bishop v. Burgard*,[22] the Illinois Supreme Court held that the Illinois common fund doctrine is not preempted by ERISA and that the doctrine requires the health plan's reimbursement recovery to be reduced by a share of the beneficiary's attorney's fees, even if the plan language seeks to avoid such reduction. In that matter, Catherine Bishop sustained injuries in an auto accident with Burgard. Bishop was an employee of Wal-Mart and covered by the company's ERISA health plan. The plan incurred $8,576.30 in medical expenses for Bishop. Bishop sued Burgard and eventually accepted Burgard's settlement offer of $21,500. Bishop's attorney filed a petition for adjudication of lien in state court acknowledging that the plan claimed a lien in the amount of $8,576.30 but stating that the plan refused to reduce the lien by one-third to reflect attorney's fees owed pursuant to the Illinois common fund doctrine.

The plan moved to dismiss on the ground that ERISA preempted the state court lien adjudication petition, which was denied by the circuit court. Bishop and her attorney and the plan then cross-moved for summary judgment, with the plan attaching pertinent versions of the benefit plan containing reimbursement provisions requiring the beneficiary to bear all of her own attorney's fees. The circuit court granted summary judgment to Bishop and her attorney, reducing the plan's lien by one-third pursuant to the common fund doctrine. The Illinois Appellate Court agreed with the circuit court to the effect that the lien adjudication petition was not preempted by ERISA, but the Appellate Court held that the circuit court erred in applying the common fund doctrine rather than the terms of the plan, which did not allow for a reduction for Bishop's attorney's fees.[23]

On appeal to the Illinois Supreme Court, the court held that the common fund doctrine is not preempted by ERISA and that the terms of the plan did not prevent its application. As to preemption, the court held that a claim for attorney fees based upon the common fund doctrine is not defeated by either the doctrine of conflict preemption or the doctrine of complete preemption in that the common fund doctrine is a law of general application that does not relate to or conflict with the ERISA plan[24] and because the doctrine of complete preemption, under ERISA Section 502(a)(3), would only apply to claims by participants, beneficiaries, or fiduciaries.[25] A claim for fees pursuant to the common fund doctrine is an independent claim that belongs to the attorney, and the attorney is not a participant, beneficiary, or fiduciary of the plan. For the same reason, the attorney

is not bound by a provision in the plan that purports to shield the plan from having to pay a portion of the beneficiary's attorney's fees.[26] Accordingly, the Wal-Mart plan's reimbursement recovery was reduced by a share of Bishop's attorney's fees.

In *Primax Recoveries, Inc. v. Sevilla*,[27] the Seventh Circuit agreed with the Illinois Supreme Court in *Bishop* that the claim for common fund attorney's fees neither arises under nor is preempted by ERISA and that the claim belongs to the beneficiary's attorney. Because the attorney is not a party to the ERISA plan, nor a participant, beneficiary, or fiduciary under the ERISA statutory scheme, the attorney's common fund fee claim is not subject to plan language attempting to negate it.

In a subsequent case, however, *Administrative Comm. of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Varco*,[28] the plan succeeded in recovering the entire amount it had paid in medical benefits, unreduced by a share of the beneficiary's attorney's fees. How did this happen? It happened because the beneficiary's attorney took his full one-third fee out of other funds in the settlement prior to the resolution of the plan's reimbursement claim. Thus, the settlement funds in the beneficiary's possession were not encumbered by any common fund fee claim still owned by the beneficiary's attorney.[29]

The lesson here for personal injury plaintiffs and their attorneys is that the attorney has to stay in the game and not take his or her full fee from the settlement until the reimbursement claim of the ERISA plan is resolved. Further, if the ERISA plan will not accept a reduction in its lien pursuant to the common fund doctrine,

the personal injury plaintiff and his or her attorney should file a petition to adjudicate the ERISA plan's lien in state court, relying on *Bishop v. Burgard*.

## Conclusion

An ERISA health plan needs to have a clear reimbursement provision in its plan document if it is to succeed in recovering the medical expenses that it has paid as a result of the beneficiary's accident. To enhance the amount of recovery, the plan document should include language disclaiming the make-whole doctrine so that the plan can be reimbursed to the fullest extent, regardless whether the beneficiary has been fully compensated by the third party. The plan document should also have a discretionary clause giving the plan administrator discretion to interpret and apply the terms of the plan.[30] The plan should closely follow the beneficiary's suit or claim against the third party in order to be in a position to assert its reimbursement rights before the settlement proceeds are dissipated. As an alternative to reimbursement, or as a fall-back if reimbursement fails, some plans might consider adopting plan language to allow the plan to suspend the payment of future medical expenses until it has, in effect, recouped the prior amount paid, up to the amount of the beneficiary's recovery.[31]

The beneficiary and his or her attorney, on the other hand, should demand to see the plan document to assure themselves of the existence of the reimbursement provision and its terms. The right to examine the plan document is guaranteed by ERISA Section 104(b)(2), 29 U.S.C. § 1024(b)(2), and a penalty of up to $110 per day is available if the plan fails to provide the plan document within 30 days, pursuant to ERISA Section 502(c)(1), 29 U.S.C. § 1132(c)(1), and the Department of Labor regulations thereunder. If the plan document contains a reimbursement

provision, the beneficiary and his or her attorney need to determine what funds from the settlement might be "lienable" by the plan under *Sereboff* and whether there are arguments that the plan's reimbursement would not be "appropriate." Finally, in light of *Varco*,[32] the beneficiary's attorney should not take his or her full fee out of the settlement until the plan's reimbursement claim is resolved.

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[1] *Schultz v. Gotlund*, 138 Ill. 2d 171, 561 N.E.2d 652, 149 Ill. Dec. 282 (1990) (hospital expense policy). See also *American Family Ins. Group v. Cleveland*, 356 Ill. App. 3d 945, 827 N.E.2d 490, 292 Ill. Dec. 961 (4th Dist. 2005) (medical payments provision in automobile liability policy contained subrogation clause, without which reimbursement would not have been permitted).

[2] 29 U.S.C. §1102(a)(1) ("Every employee benefit plan shall be established and maintained pursuant to a written instrument."); 29 U.S.C. §1102(b)(4) ("Every employee benefit plan shall specify the basis on which payments are made to and from the plan."); *Saret v. Triform Corp.*, 662 F. Supp. 312, 316 (N.D. Ill. 1986) ("The writing requirement is a central feature of ERISA, not a mere technicality. It secures to the plan's participants and administrators a clear understanding of their rights and obligations.").

[3] 534 U.S. 204, 122 S. Ct. 708, 151 L. Ed. 2d 635 (2002).

[4] 508 U.S. 248, 113 S. Ct. 2063, 124 L. Ed. 2d 161 (1993).

[5] 534 U.S. at 210 (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. at 256).

[6] Id. at 212.

[7] Id. at 213-14 (citations and emphasis omitted).

[8] Id. at 214.

[9] *Mid Atl. Med. Servs., LLC v. Sereboff*, 407 F.3d 212, 218-19 (4th Cir. 2005); *Administrative Comm. of Wal-Mart Assocs. Health & Welfare Plan v. Willard*, 393 F.3d 1119, 1124-25 (10th Cir. 2004); *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348, 356 (5th Cir. 2003); *Administrative Committee of Wal-Mart Stores, Inc. Associates' Health & Welfare Plan v. Varco*, 338 F.3d 680 (7th Cir. 2003); *Great-West Life & Annuity Ins. Co. v. Brown*, 192 F. Supp. 2d 1376, 1380-81 (M.D. Ga. 2002).

[10] *Providence Health Plan v. McDowell*, 385 F.3d 1168, 1174 (9th Cir. 2004); *Qualchoice, Inc. v. Rowland*, 367 F.3d 638, 648-50 (6th Cir. 2004); *Westaff (USA) Inc. v. Arce*, 298 F.3d 1164 (9th Cir. 2002).

[11] *Sereboff v. Mid-Atlantic Medical Services, Inc.*, ___ U.S. ___, 126 S. Ct. 1869, 164 L. Ed. 2d 612 (2006).

[12] 126 S. Ct. at 1874.

[13] 232 U.S. 117, 34 S. Ct. 276, 58 L. Ed. 530 (1914).

[14] 126 S. Ct. at 1875.

[15] Id.

[16] Id. at 1876.

[17] Id. at 1877, n. 2.

[18] Concerning the make-whole doctrine and ERISA, see *Cutting v. Jerome Foods, Inc.*, 993 F.2d 1293 (7th Cir. 1993) (holding that make-whole doctrine can be disclaimed by plan language and that plan administrator with discretionary authority could interpret the language at issue so as to disclaim the doctrine). But see *Hartenbower v. Electrical Specialties Co. Health Benefit Plan ex rel. Kepple & Co.*, 977 F. Supp. 875, 883 (N.D. Ill. 1997) ("[A]lthough ERISA does not require that an employee welfare plan follow the make-whole doctrine, it should plainly state any intention not to do so."); *Providence Health System-Washington v. Bush*, 2006 U.S. Dist. LEXIS 81912 (D. Wash. 2006) ("While the discretion conferred upon the plan administrator is necessarily broad, it cannot be exercised in such a way as to abrogate important rights of the beneficiary [the make-whole doctrine] without so much as a hint that the parties intended such an outcome.").

[19] Colleen Medill, *Resolving the Judicial Paradox of Equitable Relief Under ERISA Section 502(a)(3)*, 39 John Marshall L. Rev. 827 (2006); John H. Langbein, *What ERISA Means by "Equitable": The Supreme Court's Trail of Error in Russell, Mertens, and Great-West*, 103 Columbia L. Rev. 1317 (2003).

[20] See *McDonald v. Household Int'l, Inc.*, 425 F.3d 424 (7th Cir. 2005), where the plaintiff's employer inexplicably failed to enroll him in the company health plan and activate his coverage, resulting in the plaintiff being unable to fill his prescriptions for blood pressure medication and then suffering a stroke. The court held that "he cannot recover consequential damages in an ERISA action, *at least as matters stand at present*." Id. 429-30 (emphasis added). The plaintiff's only "remedy" was his medical expense coverage once he became enrolled in the plan.

[21] As reflected by the Fourth Circuit's opinion in *Sereboff*, the plan document *required* that the plan's reimbursement be reduced by a ratable share of the beneficiary's attorney's fees. *Mid Atl. Med. Servs., LLC v. Sereboff*, 407 F.3d 212, 220 (4th Cir. 2005).

[22] 198 Ill. 2d 495 (2002).

[23] Bishop v. Burgard, 317 Ill. App. 3d 923, 741 N.E.2d 306, 251 Ill. Dec. 712 (3d Dist. 2000).

[24] 198 Ill. 2d at 501-502.

[25] Id. at 503-506.

[26] Id. at 506.

[27] 324 F. 3d 544 (7th Cir. 2003).

[28] 338 F. 3d 680 (7th Cir. 2003).

[29] Id. at 691.

[30] See *Cutting v. Jerome Foods, Inc.*, 993 F.2d 1293 (7th Cir. 1993).

[31] See *Northcutt v. General Motors Hourly Rate Employees Pension Plan*, 467 F.3d 1031 (7th Cir. 2006).

[32] 338 F. 3d 680 (7th Cir. 2003).